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ORIGINAL

Application of United Utility Companies, Inc. for approval of a new schedule of rates and charges for water and sewer service in its certificated service areas in South Carolina.

S. C. PUBLIC SERVICE COMMISSION
RECEIVED
UTILITIES DEPARTMENT

Docket No. 2000-210-W/S

S. C. PUBLIC SERVICE COMMISSION
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JAN 30 2002

Testimony of Vivian B. Dowdy Audit Department

Public Service Commission of South Carolina

RETURN DATE: 9L D. Werts
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TESTIMONY OF VIVIAN BROWN DOWDY

FOR

THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

DOCKET NO. 2000-0210-W/S

IN RE: UNITED UTILITY COMPANIES, INC.

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.

A. My name is Vivian Brown Dowdy. My business address is 101 Executive Center Drive, Columbia, South Carolina. I am an Auditor for the Public Service Commission of South Carolina.

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND YOUR BUSINESS EXPERIENCE.

A. I received a B.S. Degree in Accounting from the South Carolina State University in 1977 and a M.A in Business and Management from Webster University in 1994. I was employed by this Commission in January 1980. I have participated in rate cases involving gas, electric, telephone, and water and wastewater utilities and have testified before this Commission. I have 22 years of auditing experience.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY INVOLVING UNITED UTILITIES, INC?

A. The purpose of my testimony is to set forth, in summary form, the Staff's findings and recommendations resulting from our review of the Company's application in this docket. These findings and recommendations are set forth below and in the report of the Audit Department with attached exhibits.

Q. I SHOW YOU THIS DOCUMENT. WOULD YOU IDENTIFY IT PLEASE?

A. This is the "Public Service Commission of South Carolina, Commission Staff Report, United Utility Companies, Inc. Docket No. 2000-0210-W/S, Application for Rate Increase."

Q. DID YOU PREPARE, OR CAUSE TO BE PREPARED UNDER YOUR DIRECTION AND SUPERVISION, A PORTION OF THIS DOCUMENT?

A. Yes, with the exception of that portion which is tabbed Utilities Department, I prepared the report with assistance from the Audit Department Staff.

Q. (MARK FOR IDENTIFICATION). NOW WOULD YOU EXPLAIN THE CONTENTS OF THIS REPORT?

A. As outlined in the Index of Staff's report, the first 5 pages contain the report's analysis. The remaining pages consist of exhibits which were prepared to show various aspects of the Company's operations and financial position. The major portion of my testimony will refer to Audit Exhibit AC, Operating Experience, Rate Base, Rate of Return and Operating Margin for the test year ending December 31, 2000 for the Company's Combined Operations as shown on page 6 of the Staff's report. Rate of Return and Operating Margin for Water and Sewer Operations are shown on Exhibits AW and AS, respectively. Staff prepared this exhibit in compliance with the Commission's standard procedures for Water and Wastewater utility rate increases.

Q. WOULD YOU EXPLAIN THE FORMAT OF EXHIBIT AC, AW, and AS?

A. Column (1) shows the Company's per book balances as of December 31, 2000. Staff verified the per book balances to the Company's books and records.

Column (2) shows the Staff's accounting and pro forma adjustments designed to normalize the Company's per book operations.

Column (3) shows Staff's computation of the Company's normalized test year prior to giving effect for the proposed increase.

Column (4) shows the Staff's adjustments for the proposed increase as furnished by the Utilities Department and the adjustments associated with the additional revenue.

Column (5) shows the Staff's computation of the normalized test year after the accounting and pro forma adjustments and the effect of the proposed increase and its associated adjustments.

Q. WOULD YOU PLEASE ELABORATE ON THE CALCULATIONS IN EXHIBIT AC, AW, and AS?

A. Amounts shown for Combined Per Book operations were verified to the books and records of the Company during Staff's examination with the exception of Customer Growth and Cash Working Capital which are shown as Exhibits A-2 and A-3, respectively. For Combined operations Staff computed a Rate of Return on Rate Base Per Books of (6.42) % and an Operating Margin of (19.00) %. For Water Operations, Staff computed a Rate of Return on Rate Base Per Books of 9.25% and an Operating Margin of 30.80%. For Sewer Operations the Rate of Return on Rate Base Per Books is (8.50) % and the Operating Margin is (24.13) %. After accounting and pro forma adjustments, the Rate of Return on Rate Base is (4.72) % for Combined Operations, 6.24% for Water Operations and (6.19) % for Sewer Operations. Operating Margin as adjusted is (24.66) % for Combined Operations, 6.63 % for Water Operations, and (27.89) % for Sewer Operations. The Company is requesting additional gross annual revenues of $294,752 or an increase of $8,938 for Water and $285,814 for Sewer. After the requested increase, Staff computed a Return on Rate Base of 13.22% for Combined Operations, 10.84% for Water Operations and 13.54% for Sewer Operations. The Operating Margin after the requested increase is 13.60% for Combined Operations, 17.90% for Water Operations, and 13.29% for Sewer Operations.

Q. WOULD YOU PLEASE EXPLAIN THE ACCOUNTING AND PRO FORMA ADJUSTMENTS IN EXHIBIT A-1?

A. Yes, Staff has made accounting and pro adjustments for known and measurable changes to test year operations. These adjustments are shown on Audit Exhibit A-1, and are designated as either (U) for Utilities Department or (A) for Audit Department. My testimony will address those adjustments designated as (A).

Adj. # 1 Operator's Salaries- The Staff and Company propose to annualize the operators' salaries for the test year. Staff annualized the payroll at 12-26-2000 for total annualized wages of $109,589. From this amount, Staff subtracted per book wages of $108,006 resulting in Staff's adjustment for annualized wages. Staff capitalized a portion of the annualized wages representing the time operators spend on capital projects. Staff capitalized 12.40% or $196 of the wage adjustment and expensed $1,387. Staff's wage capitalization rate is based on the actual wages capitalized per books. Staff computed taxes other than income of $(2). The Staff and Company annualized Pensions & Benefits to match end of test year wages and salaries. The Company annualized salaries using year-end payroll less per book wages for an adjustment of $6,701. The Company's annualization included a terminated operator's position which the Staff did not include. The Company did not propose to capitalize operator's salaries.

Adj. #2 – Office Salaries – The Staff and Company propose to annualize office salaries. Staff annualized the year-end payroll totaling $14,827. From this amount, Staff subtracted the per book amount of $15,342 for a net adjustment of $(515). Staff also reduced Pensions & Benefits by $(1,436). The Staff and Company annualized Pensions & Benefits to match end of test year wages and salaries. Staff adjusted G & A expenses for the wage adjustment of $(515) and Pensions & Benefits of $(1,436) totaling $(1,951). The Company annualized wages using the 12-26-2000 payroll and subtracted per book wages. However, the Company's adjustment of $2,067 included the annualized salary of a retired employee whom Staff removed. The total office salaries are booked to General and Administrative Expenses.

Adj. #3 – Other Office Expenses – The Company proposes to increase other office expenses for extra costs associated with its proposal to change its billing cycle from bi-monthly to monthly billing. The Company would incur additional postage, paper, envelopes, and bank charges expenses. The Company has not implemented this change. If the Commission were to approve such a change, Staff has verified an additional cost of $3,821 for six additional billings by the Company.

Adj. #4 – Employee Bonuses – The Staff proposes to remove bonuses for United Utility and WSC employees. Full time employees received a bonus of $100 and part-time employees received $50. Staff removed $208 for bonuses for United Utility employees and WSC bonuses allocated to United Utility of $12, which included FICA expense. Bonus payments are considered to be the responsibility of the stock holders and are sometimes non-recurring expenses.

Adj. #5 – Update of Customer Equivalents - The Staff proposes to adjust common expenses, direct salaries, and the Columbia office for up-dating customer equivalents to 12-31-2000. The Staff is proposing this adjustment because it is a known and measurable change. Staff recalculated the allocation factors and applied the factors where applicable in the allocation process. As a result, Operating and Maintenance expenses decreased by $(459), General and Administrative Expenses by $(19), Depreciation and Amortization by $(22) and Taxes Other Than Income by $(37).

Adj. #6 - Rate Case Expenses – The Staff and Company propose to adjust for rate case expenses. The Staff's adjustment includes recomputing an executive salary to be $3,800 using a base salary rate and actual time spent on the rate case. Staff included actual rate case notices, postage, and envelopes of $514. Staff amortized total expenses of $4,314 over a three-year period, for a total adjustment of $1,438. Staff used a three-year amortization period. Staff is of the opinion that a 3-year period is reasonable time to recover rate case expenses. The Staff used actual rate case expenses in its adjustment. The Company proposes to amortize estimated rate case expenses of $76,625 over three years for a total adjustment of $25,542. The Company's adjustment included mostly estimated expenses - legal fees of $50,000, travel of $2,600, executive salaries of $14,025, and the expense for a cost of capital witness of $10,000, for a total cost of $76,625, amortized over three years.

Adj. # 7 – Nonallowable Expenses - The Staff disallowed expenses which are considered non-allowable for ratemaking purposes. Staff disallowed direct expenses to United Utility totaling $339. Staff also disallowed the portion of Water Service Corporation (WSC) common expenses allocated to United Utility, that is considered nonallowable for ratemaking purposes. These expenses included out of test year expenses, flowers, ½ chamber of commerce dues, and employee newsletters. The Staff is of the opinion that these expenses are not necessary for the provision of good utility service. The total WSC expenses amounted to $12,323, of which United Utility was allocated 0.682% or $84. Staff also reclassified items which should be capitalized. The total of $3,587 was non-allowable expenses to be capitalized of which United Utility was allocated 0.60% or $22.

Adj. # 8 – Depreciation Expense Adjustment – Both Staff and the Company propose to annualize Depreciation Expense. The Staff's adjustment included completed plant of $24,389 less plant retirements of $13,490 added to Gross Plant of $3,067,547. Gross plant was then reduced by Organization Expense - $6,000, Land - $19,437, Vehicles - $44,701, Computers - $1,122, and Contributions In Aid of Construction

(CIAC) of $1,882,870. Staff applied the Depreciation Rate of 1.50% to net plant for total expense of $16,865. Staff then applied a 20% Depreciation rate to vehicles that were not fully depreciated, for a total of $8,940. Staff depreciated Computers using a depreciation rate of 20% amounting to depreciation expense of $224 and included depreciation expense associated with the WSC Rate Base of $997. Staff's Total computed Depreciation amounted to $27,026. Subtracting the per book amount of $25,015, resulted in an adjustment of $2,011. The Depreciation rates used by the Staff were recommended by the Utilities Department. The Company's adjustment included plant additions estimated at $80,000. Gross plant was not reduced for organizational expense and computers before applying the rate of 1.50%. The Company did not remove fully depreciated vehicles, include WSC Rate Base Depreciation Expense, or reduce depreciation by the amortization of Excess Book Value. Including the amortization of CIAC, the Company's net adjustment amounted to $4,278.

Adj. #9 – Gross Receipts Tax Increase - The Company proposes to increase gross receipts taxes by 5%. Staff was unable to verify such an increase in gross receipts taxes. The Staff used the most current gross receipts factor in the adjustment to reflect the proposed increase, which is .011868167.

Adj. #10 – Income Taxes - The Staff and the Company propose to adjust for the effect of income taxes after accounting and pro forma adjustments. Both Staff and Company use a 5% rate for state taxes and a 34% rate for federal taxes. Staff includes operating revenues less operating expenses to compute as adjusted Income

Taxes. Staff's adjustment for state and federal income taxes was $(3,878). The Company's adjustment for state and federal taxes totals $(18,343) reduction to per book taxes.

Adj. #11 - Interest Synchronization – The Staff and Company propose to include the effects of interest synchronization on Income Taxes. Interest synchronization is a ratemaking procedure which imputes interest expense for income tax purposes. Staff used $42,752 of interest expense which is the Total Income for Return needed to cover embedded cost rates on long-term debt as computed on Staff Exhibit AC4. The Staff increased interest expense over the amount contained on the Company's books by $38,151. Staff's adjustment was computed to be $(14,239). The Company increased interest expense by $42,800 and its adjustment was computed to be $(15,964).

Adj. #12 – Interest on Customer Deposits – The Staff proposes to annualize Interest on Customer Deposits by using the account balance at 12-31-2000 of $23,294 and applying the Commission approved interest rate of 8%. Staff computed annualized Interest on Customer Deposits of $1,864 less the per book amount of $2,338 for an adjustment of $(474).

Adj. #13 – Allowance for Funds Used During Construction (AFUDC) – The Staff and Company propose to remove the income associated with capitalized interest on projects under construction. The AFUDC is allowed as an offset to the Interest capitalized when the plant is under construction. Such projects were closed to plant after the test year ended. The Company and Staff propose to remove the total AFUDC of $1,991.

Adj. #14 – Capitalized Wages and Benefits – The Staff proposes to capitalize wages associated with the annualization of the operators' salaries. Staff capitalizes 12.40% of the wages and benefits which amounts to $196. Staff's capitalization ratio is based on actual wages capitalized during the test year.

Adj. #15 – Officers' Bonuses and Salary Increases - The Staff proposes to remove bonuses and officers' salary increases from capitalized wages. Staff recomputed the capitalized salary rates of 2 officers of Water Services Corporation who charged time directly to United Utility. The recomputed rate only includes the base salary, payroll taxes, pension and benefits. Staff computed total capitalized salaries of $472 less per book salaries of $820 for a total adjustment of $(348.) Staff also proposes to disallow officers' test year salary increases of 3%. Staff reduced the base salary rates by 3%, for officers' salary increases, for a total reduction of $(13).

Adj. # 16 – Plant Sample Items – WSC – The Staff proposes to increase plant for a portion WSC expenses which should have been capitalized. Staff removed $3,587 from WSC's expenses for a mailing machine and allocated 0.60% to United Utility, amounting to $22. The Staff allocated the WSC expense using the WSC rate base allocation composite factor of 0.60%.

Adj. #17 – Plant Additions – The Staff and Company propose to adjust for plant additions made after the test year ended. Staff verified a total of $24,389 for completed plant additions and $13,490 for plant retirements made after the test year. Additions included the purchase and installation of a portable generator.

Adj. # 18 – Water Services Rate Base - The Staff proposes to adjust the WSC Rate Base allocated to United Utility. Staff verified the rate base to WSC's books and records and removed deferred charges of $40,526 and adjusted Accumulated Deferred Income Taxes. Staff allocated WSC's rate base based on updated customer equivalents for the total WSC Rate Base allocated to United Utility of $12,683. Per Book rate base amounted to $13,397 resulting in a total adjustment of $(714). The adjustment is a known and measurable change.

Adj. # 19 – Accumulated Depreciation - The Staff proposed to adjust accumulated depreciation to correspond to Staff's adjustment for annualized depreciation. Staff computed an increase to depreciation expense of $2,011. The Staff increased Accumulated Depreciation by this amount.

Adj. #20 – Cash Working Capital Allowance – The Staff proposes to adjust Cash Working Capital for Staff's adjustments to O & M expenses which correct the books, such as removing nonallowables, etc. Staff's adjustment amounted to $(143). The Company's adjustment amounted to $4,419. It was based on the Company's adjustments. Staff also notes that the Company used Taxes Other Than Income in computing Cash Working Capital. Staff does not include this expense since it is normally an accrual not requiring a cash outlay until such taxes become payable. The Company would have collected from its customer's funds in advance of paying such taxes. The Allowance represents the amount of cash needed by the Company to operate efficiently and economically on a day to day basis. The forty-five day allowance is needed because the Company renders monthly service before it collects from the customer. Forty-five days is based on 30 days of rendering service plus an additional 15 days to read meters, prepare bills, bill customers, and collect from its customers.

Adj. #21 – Interest on Customer Deposits - The Staff proposes to adjust for Interest on Customer Deposits. The Company booked accrued interest in a separate account. The Staff proposes to reduce Rate Base by the Interest Accrual of $(20,405) which is owed to the Company's customer.

Adj. #26 – Proposed Increase - Staff and Company propose to adjust for the effect of the proposed rates and charges. Staff and Company propose to include service revenues of $294,752 for combined operations, $8,938 for water and $285,814 for sewer operations. The Staff and Company propose to adjust for uncollectible revenue associated with the proposed revenues using the uncollectible factors for the test year of 2.76% for water and 3.14% for sewer. Staff and Company computed gross receipts taxes associated with the proposed revenue using the most recent gross receipts factor of .011868167. Staff and Company computed Income Taxes associated with the proposed increase. Staff computed Customer Growth associated with the increase of $845, as shown on Exhibit A-2.

Q. HAS THE STAFF COMPUTED A RETURN ON COMMON EQUITY FOR UNITED UTILITY COMPANIES?

A. Included as Audit Exhibits AC-4, AW-4, and AS-4 is Return on Common Equity for

Combined Operations, Water Operations, and Sewer Operations, respectively. Staff has utilized the parent company, Utilities, Inc.'s capital structure and embedded cost of Long-Term Debt at December 31, 2000. Staff has computed Return on Common Equity on adjusted operations of (18.11) % for Combined Operations, 3.85 % for Water Operations, and (21.06) % for Sewer Operations. After the requested increase, the Return on Common Equity computed by Staff for Combined Operations is 17.84%, 13.06% for Water Operations, and 18.48% for Sewer Operations.

Q. WOULD YOU PLEASE EXPLAIN THE CUSTOMER GROWTH CALCULATION?

A. Exhibit A-2 details Staff's calculation of Customer Growth. The Water Operations had no customer growth for the test year. Customer Growth for the Sewer Operations was calculated only after the proposed increase, because Staff does not recognize negative growth.

Q. HAS THE STAFF CALCULATED REVENUE REQUIREMENTS?

A. Included as Exhibit A-5 are the requirements for revenues using Staff's adjustments presented on Exhibit AC and the ranges of return presented by the Staff's and the Company's cost of capital witnesses.

Q. WHAT ARE THE REMAINING EXHIBITS CONTAINED IN THE REPORT?

A. Exhibit A-3 -Cash Working Capital Allowance.

Exhibit AC- 4 - Return on Common Equity-Combined

Exhibit AW-4 - Return on Common Equity-Water

Exhibit AS-4 - Return on Common Equity-Sewer

Exhibit A-6 - Income Statement

Exhibit A-7 - Balance Sheet

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.